
**Leadership Transition and Global Governance:**

**Role Conception, Institutional Balancing, and the AIIB**

The establishment of the Asian Infrastructure Investment Bank (AIIB) has signified a ‘charm offensive’ of China toward multilateral institutions and existing global financial governance. If the rise of China is inevitable, what will the future world look like and what should other countries be prepared for? Borrowing insights from institutional balancing theory and role theory in foreign policy analysis, this project introduces a ‘leadership transition’ framework to explain policy dynamics in global governance with the AIIB as a case study. It suggests that China, the United States, and other countries have employed different types of institutional balancing strategies, i.e. inclusive institutional balancing, exclusive institutional balancing, and inter-institutional balancing, to compete for influence and interest in the process of establishing the AIIB. A state’s role identity as a ‘leader’, a ‘challenger’, or a ‘follower’ will shape its policy choices regarding different institutional balancing strategies in the process of ‘leadership transition’ in global governance. Institutional balancing is a new type of balancing among states in the future transformation of global governance. China’s institutional rise in global governance might be more peaceful than widely predicted.
Leadership Transition and Global Governance:
Role Conception, Institutional Balancing, and the AIIB

The Asian Infrastructure Investment Bank (AIIB) is one of the hottest topics in today’s world politics. Since the initiation of the AIIB idea by China in 2013, the development of the AIIB has been full of suspicions, surprises, and dynamics. When the AIIB was officially established in March 2015, 57 states joined as founding members, including some developed economies, such as the United Kingdom (UK), Germany, France, Italy, Australia, and South Korea. On August 31, 2016, Canada officially applied to join the AIIB and became the first North American country to seek membership in the AIIB. To date, the US and Japan still say ‘no’ to the AIIB.

The AIIB case entails both policy relevance and academic importance for policy makers and scholars.¹ As some scholars point out, China’s initiation of the AIIB represents the start of China’s challenge to the US-led global economic governance as well as the post-war international order.² If the rise of China is inevitable, the AIIB will be the first test of China’s potential


leadership in future global governance and international order. Policy makers will be fascinated by China’s performance in the AIIB as well as its implications for US hegemony in world politics.

For scholars, the AIIB poses several intriguing research puzzles on the different responses and policy choices states have toward the AIIB. First, why did China initiate the AIIB in the first place? If China wanted to challenge the US in global economic governance, why did China keep the AIIB open to all states so that the US was also eligible to join if it wanted? Second, why did the US reject the AIIB idea and tried to dissuade its allies, such as Japan, Australia, South Korea and its European allies from joining? Finally, why did some states choose to join, such as the UK, Australia, and South Korea, while others rejected the AIIB, notably, Japan?

There are two existing arguments about the AIIB case. While some scholars lay out various ‘US faults’, others focus on elements of ‘China’s victory’ in the AIIB. One of the most popular arguments regarding US failures in the AIIB can be traced back to the IMF ‘quota reform’. The failed IMF reform, due to the block by US Congress, is widely seen as a major trigger for China’s decision to initiate the AIIB. Another mistake committed by the US government regarding the AIIB is its firm rejection of the AIIB idea in the first place. Although not admitted publicly by the US, as Stephen Roach points out, ‘the US opposed the AIIB simply because it was a Chinese initiative, full stop’. This attitude has unintentionally backfired on the US reputation and legitimacy in global economic governance. For example, despite US criticisms of the AIIB, the


World Bank’s President Jim Yong Kim openly supported the AIIB in early 2015 by saying that ‘poverty is the real enemy, not the new players [AIIB] who want to help end it’. The US was put in an odd situation, which at least casts some doubt on its actual control of the World Bank. Last, but not least, US pressure on other states, especially its allies, on the AIIB issue is seen as unwise or even ‘churlish’. As former Secretary of State Madeleine Albright later admitted, ‘We (the United States) should not have done it this way’.

Instead of focusing on US policy failures, some scholars suggest that it is China’s astute diplomacy that has led to the success of the AIIB. First, China’s AIIB initiative fills a niche in global finance governance. According to an estimate by the Asia Development Bank (ADB) in 2009, the gap in infrastructure financing in developing Asia will be around US$8 trillion between 2010 to 2020, while the current infrastructure financing in Asia from the ADB and World Bank is about US$20 billion per year. China’s AIIB initiative, to a certain extent, aims to bridge this financing gap. China’s second success is its inclusive institutional design of the AIIB. Although Asia is coined in the name of this new bank, any country is eligible to join. This inclusive institutional design has helped China reduce suspicion from other states, especially European countries. Another notable success of China in the AIIB is its skillful diplomacy in winning support from the UK. The UK can be seen as the first falling domino in the West because other Western

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countries soon followed suit to join the AIIB. In other words, China’s charm offensive toward the
UK led to its diplomatic success in the AIIB.

Although both the ‘US faults’ and ‘China’s victory’ arguments reveal some elements of
the truth about the dynamics of the AIIB, they suffer two analytical weaknesses. First, both existing
arguments are based on problematic assumptions. For example, the ‘US faults’ argument assumes
that the US should accept China’s AIIB initiative or at least should not try to ‘squash’ it.9 For the
‘China’s victory’ school, the underlying assumption is that China has provided public goods
through the AIIB that no one should reject. However, why the US should accept the AIIB is not
clear in the first place. Will it be a real diplomatic mistake or an inevitable policy choice for the
US? For China’s AIIB initiative, it is true that the AIIB creates its own niche in financing the
much-needed infrastructure development in Asia. However, this public-good-rooted altruism is
apparently not the whole story behind China’s AIIB initiative. Moreover, how China will use the
AIIB or other institutions to challenge existing global governance is unknown.

Second, while both existing arguments focus on the US and China, they fail to explain the
diverse policy choices of other states. For example, despite US pressure, Australia and South Korea
decided to join the AIIB. In contrast, Japan chose to stand with the US. Since all three countries
are US allies in the Asia-Pacific, an unanswered question remains: why did they adopt different
policies toward the AIIB? In addition, why did the UK and other European powers seem to have
an easier choice than Australia and South Korea regarding the AIIB? The AIIB will not be the last
institutional challenge posed by China toward the US. How other states respond to a similar
situation will directly influence the outcome of US-China competition in the international system.

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9 Zachary Keck, ‘Why the US is Trying to Squash China’s New Development Bank’, The Diplomat, 10
October, 2014.
Merely blaming US faults or praising China’s success will not provide a satisfactory answer to this system-transition-related question.

In this paper we attempt to answer the above question through a new theoretical perspective— a ‘leadership transition’ argument. Integrating institutional balancing theory and role theory in foreign policy analysis, we suggest that the AIIB represents a ‘leadership transition’ dynamic in global economic governance through which the US and China have competed for leadership and other states have had to pick sides between these two great powers. Depending on their different role identities in this ‘leadership transition’ game, states choose different types of institutional balancing strategies, including inclusive institutional balancing, exclusive institutional balancing, and inter-institutional balancing, to pursue their influence and interest in this evolving and transitional process of global governance.

In particular, we suggest that as the existing leader, the US will not easily give up its leadership role, and thereby it is more likely to adopt an exclusive institutional balancing strategy to reject any potential challenge to the existing system. As the challenger of the existing system, however, China needs to seek recognition and legitimization of its rising role and status in the system. This is why China is more likely to choose an inclusive institutional balancing strategy to invite as many supporters as possible, including the US, to join the institution that it has initiated. As to other states that are followers in this ‘leadership transition’ game, their policy choices will be shaped by their ‘balance of specific interests’ considerations. If a state perceives specific benefits from this new institution, it is more likely to ‘bandwagon for profit’— joining the new institution initiated by the challenger for the benefits that the old governance institution cannot provide. However, if the state does not perceive specific benefits from the new institution, it is
more likely to choose to ‘bandwagon for stability (or security)’ — standing with the existing leader to retain the status quo in the system.10

This paper consists of three sections. First, we introduce our ‘leadership transition’ argument through integrating institutional balancing theory and role theory to shed some light on how states use different institutional strategies in the dynamics of global governance. Second, we test our ‘leadership transition’ model through examining the diverse policy choices of the US, China, the UK, and Japan in the AIIB. In conclusion, we suggest that the AIIB case is an institutional power play between China and the US within the context of multilateral institutions in global financial governance. Although it is still too early to foresee the final outcome, the rise of China through multilateral institutions will be more peaceful than widely predicted.

The Leadership Transition Argument—A New Framework

In this paper we suggest a new analytical framework — a leadership transition argument — to shed some light on the dynamics of the AIIB as well as future US-China competition in global governance. It is worth noting that global governance is still a contested concept in international relations. In this paper, we follow Thomas Weiss and Ramesh Thakur to define ‘the problematique of global governance’ as ‘the evolution of intergovernmental institutions to facilitate robust international responses lags well behind the emergence of collective problems with transborder, especially global, dimensions’.11 Thomas Weiss and Ramesh Thakur further categorize the business of United Nations (UN) into two main arenas, security and economic affairs, i.e. global

security governance and global economic governance. We follow their approach to suggest that
global governance and leadership transition within global governance should be considered
through different issue areas. In other words, no country, including the United States, can play the
leadership role in all issue-areas of global governance. When discussing a possible leadership
transition in global governance, we will need to define which issue area is referred to regarding
global governance.

Our leadership transition argument borrows insights from institutional balancing theory
and role theory in the areas of international relations and foreign policy analysis. Institutional
balancing theory suggests that states can use different institutional strategies to pursue their realist
interests, such as power and influence, in the international system. The diverse policy choices of
states towards the AIIB entail different institutional balancing strategies in the realm of global
financial governance. Role theory, on the other hand, examines how the role identity of an
individual state shapes its policy choices regarding different institutional balancing strategies.

In institutional balancing theory there are three types of institutional balancing strategies:
inclusive institutional balancing, exclusive institutional balancing, and inter-institutional

12 Kai He, ‘Role Conceptions, Order Transition and Institutional Balancing in the Asia-Pacific: A New
13 For institutional balancing, see Kai He, ‘Institutional Balancing and International Relations Theory:
Economic Interdependence and Balance of Power Strategies in Southeast Asia’, European Journal of
International Relations, Vol. 14, No. 3 (2008), pp. 489–518; Kai He, Institutional Balancing in the Asia-
Pacific: Economic Interdependence and China’s Rise (London: Routledge, 2009); Kai He, ‘Facing the
Challenges: ASEAN’s Institutional Responses to China’s Rise’, Issues & Studies, Vol. 50, No. 3 (2014),
pp. 137–68; Kai He, ‘Contested Regional Orders and Institutional Balancing in the Asia Pacific’,
International Politics, Vol. 52, No. 2 (2015), pp. 208–22; Huiyun Feng and Kai He, ‘China’s Institutional
14 Kalevi J. Holsti, ‘National Role Conceptions in the Study of Foreign Policy’, International Studies
Analysis (Durham, NC: Duke University Press, 1987); Cameron G. Thies, ‘Role Theory and Foreign
balancing.\textsuperscript{15} Inclusive institutional balancing refers to a strategy to include a target state into an institution, through which the target state is constrained by rules and norms of the institution. One example of successful inclusive institutional balancing is the ASEAN Regional Forum (ARF), through which ASEAN states used norms and rules of the ARF, especially multilateralism and cooperative security, to constrain China’s behavior in the 1990s.

Exclusive institutional balancing means excluding the target state from an institution. The target state is excluded and pressured by the cohesion and cooperation of states inside the institution. An example of exclusive institutional balancing is the Trans-Pacific Partnership (TPP), a regional trading bloc led by the US. Although the TPP claims to be open to all countries, its high entry standards, especially on labor protection as well as restrictions on state-owned enterprises, actually preclude China from joining it in the first place.\textsuperscript{16} In the eyes of Chinese leaders the TPP is an instance of US institutional balancing against China under the Obama administration through which the US can utilize the unity and cohesion among the TPP countries to alienate China and further undermine its influence in the region.

Another vivid example of institutional balancing is the institutional dynamics of Shanghai Cooperation Organization (SCO). As an initiator of the SCO, China has enjoyed an undisputed leadership in the SCO. However, in order to countervail China’s influence in the SCO, Russia insisted on inviting India to join the SCO. China tried hard to block India’s membership of the SCO because it is in China’s interest to exclude India — another regional power — to compete for influence in the SCO. It follows the logic of exclusive institutional balancing. India’s admission


\textsuperscript{16} Another possible explanation is that China is conducting a wait-and-see strategy toward the TPP. However, even after the US withdrew from the TPP in 2017, China did not join the TPP-11, despite some domestic advocacy.
to the SCO, however, will be an inclusive institutional balancing strategy against China because India can work with Russia to constrain China’s behavior inside the SCO. In 2017, Russia’s balancing effort succeeded and India was admitted to the SCO. However, China also invited Pakistan to join the SCO at the same time so that Pakistan could offset India’s institutional pressure against China in the SCO.

Inter-institutional balancing is an extension of exclusive institutional balancing. When a state is excluded by a particular institution, it can support another or initiate a similar institution to counter-balance the pressure from the institution that has excluded it. For example, facing pressure from the TPP, China supports the Regional Comprehensive Economic Partnership (RCEP) initiated by ASEAN to counter the pressure from the TPP. Moreover, in the 2014 APEC meeting in China, China advocated the establishment of the Free Trade Agreement in the Asia Pacific (FTAAP). The FTAAP proposal can also be seen as an inter-institutional balancing effort by China against the US-led TPP through which the success of the FTAAP can reduce negative impacts of the TPP on China.

Institutional balancing theory provides a new perspective in explaining the dynamics of state behavior in the AIIB. However, it cannot explain why states choose different institutional balancing strategies in the AIIB case. For example, why did the US say ‘no’, while the UK embraced the AIIB? Why did China select an inclusive institutional design to invite all countries if more countries in the AIIB will dilute China’s influence? We integrate role theory with institutional balancing theory to shed some light on how a state will respond to the potential leadership transition in global governance.

Role theory is a research programme that includes many theories and perspectives sharing a similar view on the importance of the concept of role in social life. The ‘role’ concept is a
metaphor borrowed from the theatre. Role theorists suggest that everyone plays a certain societal role or roles through which society functions as a web composed of the roles of individuals. Role theory was introduced to foreign policy analysis and international relations in the 1970s. A major contribution of role theory to foreign policy analysis is that of providing a unique framework to integrate different theoretical perspectives into the study of foreign policy.\(^{17}\) As Thies suggests, role theory has the potential to link different levels of analysis in Foreign Policy Analysis as well as to connect agents and structures in International Relations, although the intellectual value of role theory is either overlooked or questioned in the IR field.\(^{18}\)

One major argument of role theory is that the role identity of a state shapes a state’s policy choice. In other words, how a state perceives its role in an international society will influence its policy. For example, since the Soviet Union perceived itself as the leader of the international communist movement, it got involved in domestic affairs in Eastern Europe during the Cold War. Similarly, because the US perceived its role to be a leader of global anti-communism during the Cold War, it fought the Vietnam War to prevent the ‘domino effect’ of spreading communism in Southeast Asia.

In the AIIB case, we suggest a ‘leadership transition’ argument based on institutional balancing and role theory. Since the establishment of the AIIB is widely seen as an institutional challenge to the existing global economic governance, we argue that the AIIB represents a case of


\(^{18}\) Thies, ‘Role theory and Foreign Policy’.
potential ‘leadership transition’ in global governance although whether the ‘leadership transition’ will succeed is still in question. Just like a power transition in the international system, a ‘leadership transition’ process in global governance will be triggered when a state initiates a new institution that is perceived as a threat to current global governance by the existing leading states. In addition, like power transition between a hegemon and a rising power, the ‘leadership transition’ in global governance will also take a long time to complete. Our ‘leadership transition’ model, therefore, focuses on examining institutional dynamics among different types of states during this transition period. According to role theory, we can categorize three types of roles in this ‘leadership transition’ process: the leader, the challenger, and the follower. Differing from power transition theory, which predicts military balancing in conflicts between a rising power and a hegemon, a leadership transition process in global governance takes place through the means of institutional balancing, including inclusive institutional balancing, exclusive institutional balancing, and inter-institutional balancing.19

All states need to calculate the costs and benefits when engaging in this institutional transition in global governance. For the leader state of the existing system, its authority and legitimacy will face the most serious challenges from the challenger state. Therefore, it is rational for the existing leader to minimize the institutional impacts of the rival to the existing system. The easiest and best way to achieve this goal is to reject the legitimacy and downgrade the value of a new institution in the first place. Exclusive institutional balancing, i.e. refusing to endorse and join the new institution, becomes a logical and rational policy response for the leader. Moreover, the leader state will need to dissuade others from joining the new institution as well, because the fewer the members in the new institution, the weaker the influence or impact on the existing system.

19 See He, ‘Role Conceptions, Order Transition and Institutional Balancing in the Asia-Pacific’.
For the challenger state, its immediate goal is to use a new institution to improve its power and value in the existing system. In the long run, this new institution can become an institutional base for the challenger to take over the leadership position in global governance. However, the first difficulty the challenger faces is to make the new institution relevant. In other words, the challenger has to prove to others that the new institution it initiates can provide extra benefits that the existing system cannot. To do so, the challenger has to forgo some short-term economic gains to make the new institution work. Inclusive institutional balancing is a rational policy choice for the challenger state to pool support from states in the existing system. It may be the case that the more members in the new institution, the more constraints it has for the challenger state. However, the success of the new institution will serve a long-term goal for the challenger state, which is to establish a new leadership position in the future global governance.

For other states, their role is the follower in this institutional competition between the existing leader state and the challenger state. They must pick sides between the two. They can follow the existing leader and stay away from the new institution or they can support the challenger state and join the new institution. As mentioned above, to attract followers, the challenger will offer extra benefits that the existing leader state cannot provide. Therefore, if a follower state perceives some ‘special benefits’ from the new institution, it will choose to support the challenger state by joining the new institution. However, if a follower state fails to view any benefits from the new institution, it will follow the existing leader state because the status quo situation will offer more stability and security in the system.

Integrating role theory with institutional balancing theory, our ‘leadership transition’ argument suggests the following three hypotheses:

H1. If a state identifies its role as a leader state in a certain arena of global governance, it is more likely to adopt exclusive institutional balancing or/and inter-institutional balancing
strategies to undermine the influence and value of any new institution initiated by others in the system.

H2. If a state identifies its role as a challenger state in a certain arena of global governance, it is more likely to adopt an inclusive institutional balancing strategy to pool support from other states to ensure the success of the institution it has initiated.

H3. If a state identifies its role as a follower in a certain arena of global governance, it can adopt either an inclusive or exclusive institutional balancing strategy toward the new institution. If the state perceives some specific benefits, it is more likely to support the challenger state’s new institution. Otherwise, it will follow the leader and stay away from the new institution.

Two caveats are worth noting. This ‘leadership transition’ argument is an issue-specific model of global governance. We highlight the importance of classifying different issue areas in global governance in the hypotheses. Global governance entails both rights (power) and responsibilities. As we mentioned before, no country can be a leader or challenger in all issue areas in global governance. For example, the United States has played a leadership role in the global economic governance (trading and financial systems) since World War II. However, the United States is not capable or willing to be the leader in other issue areas, such as climate changes and cultural exchanges. Therefore, our ‘leadership transition’ model is an issue-specific model, which applies to any domain of global governance where there are power dynamics among leaders, challengers, and followers. The AIIB case study in this research will serve as an empirical test for the model in global financial governance and the findings of the AIIB case. Moreover, it will shed some light on ‘leadership transition’ in other arenas of global governance.

Second, it has been an empirical challenge to gather direct evidence for the case study on the AIIB. The AIIB case took place in 2013–2015. Many related official documents are still classified. It is also very difficult to interview any officials who are directly involved in the AIIB because of the sensitivity of the events. Consequently, we have to rely on secondary sources, such
as newspaper reports, to conduct our preliminary research on different countries’ policy behaviors toward the AIIB. This study, therefore, can be seen as a theory-driven plausibility probe, which will inspire more research and hypothesis testing in the future.

In our case study, we perform a congruence test to examine the validity of these hypotheses. In the congruence test, we explore four countries’ policy choices toward the AIIB. These four countries are the US, China, the UK, and Japan. In each case, we examine the relationship between these states’ role identities and their policy choices toward the AIIB. If a state’s role identity is convergent with their policy choice as we suggest in the hypotheses, then our model passes the congruence test. If not, our hypotheses are falsified and we need to explore other variables to explain this divergent outcome.

The Game of Balancing in the AIIB

According to role theory, there are two steps for a state to identify its role. First, a state or leaders of the state need to go through a role identification process for the self to specify which role the state will perform. Second, this role identity for the self must be confirmed by the outside world. If the outside world confirms the state’s self-identified role, the state finalizes its role identification process. If the outside world rejects the state’s self-identified role, the state will need to renegotiate its role with the outside world. The difference between the self’s role identification and role confirmation sometimes leads to policy failures as well as confrontations between the state and the outside world.20

US Existing Hegemon Role and Exclusive Institutional Balancing

The US has seen itself as the leader of the international system since the end of World War II. As mentioned above, its leadership has been built on its military strength as well as the Bretton Woods system in global economic governance. In its 2015 National Security Strategy document, the US clearly states that ‘Strong and sustained American leadership is essential to a rules-based international order that promotes global security and prosperity as well as the dignity and human rights of all peoples. The question is never whether America should lead, but how we lead’.21 In this 35-page document, ‘leadership’ was emphasized 15 times. In other words, the US is not shy about its presumed leadership in the world.

This self-identified role of the US as the leader in global governance is also confirmed by the outside world. For example, in a recent interview with the Wall Street Journal, Singapore Prime Minister Lee Hsien Loong clearly points out that the ‘US might be roiled by politics, but its leadership on trade and security is indispensable…and the world simply has found no substitute for American leadership’.22 More importantly, China also publicly confirms US leadership in the world. In late 2014, Chinese Vice Premier Wang Yang made a public speech saying that, ‘it is the United States that leads the world. We have a clear understanding of this…China does not have any ideas or capabilities to challenge the US as the world’s leading superpower’. Scholars and policy makers have questioned the true meaning of Wang’s statement. For example, David Shambaugh suggests that Wang’s statement is just a disguise for China’s ambition and Washington ‘must not confuse rhetoric with reality’. Some top Chinese IR scholars, however, suggest that

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Wang’s comments reflect what Chinese leaders really think. No matter whether China has ambitions or not, it is clear that Chinese leaders acknowledge who the leader of the existing system is.

As the leader state in global financial governance, the US is more likely to choose an exclusive institutional balancing strategy toward China’s AIIB initiative according to our ‘leadership transition’ argument. In reality, the US adopted three ‘no’ policies toward the AIIB. First, it did not endorse the AIIB idea. It argued that the AIIB is redundant because the existing system has the World Bank, IMF, and ADB. Although the White House did not publicly criticize the AIIB, according to the Wall Street Journal, the US administration regards the AIIB as ‘China’s vehicle for creating a rival to the US-led World Bank’. Second, the US did not join the AIIB. Although China has lobbied hard and many US scholars and policy advisors have also advocated joining the AIIB, Washington still says ‘no’ to the AIIB. According to the New York Times, Evan Medeiros, a Senior Adviser of Obama’s National Security Council, told a Chinese delegation led by Jin Liqun — the later AIIB President who intended to lobby Washington to embrace the idea of AIIB in 2014 — that ‘I am not going to buy the cake you have cooked’. It is reported that Jin replied, ‘you are always welcome into the kitchen to help with the baking’. Here, the real problem is not about the ‘cake’, but about the ‘kitchen’. The United States would not like to enter the kitchen where it did not play a leading role.

25 Jane Ferlez, ‘China Creates a World Bank of its Own, and the US Balks’, The New York Times, 4 December, 2015. It is worth noting that Evan Medeiros disputed the report regarding his conversation with Jin Liqun. However, the original source who described the conversation stood by the account.
Third, the United States tried to convince its allies to reject the AIIB. As reported by the *New York Times*, Caroline Atkinson, the deputy national security adviser for international economics, is a strong defender of the existing system and the major player who intended to influence the membership of the AIIB. At a series of high-level meetings, Atkinson and her colleagues tried to form a ‘containment strategy’ against the AIIB. In particular, ‘Australia and South Korea were discouraged from signing up, and G-7 countries were advised that the United States wanted a united front’. 26 Through these three ‘no’ policies, it is the US goal to alienate, undermine, and even delegitimize the value of the AIIB in global economic governance. If only small Asian countries join the AIIB, the relevance and power of the AIIB as well as China’s challenge toward the existing system will be discounted and reduced.

It is worth noting that it is not the first time the US has crusaded against institutional challenges to its leadership in global economic governance. In 1990, Malaysian Prime Minister Mahathir Mohamad proposed a free trade zone, the East Asian Economic Caucus (EAEC), to encourage trade and economic cooperation among ASEAN states and three East Asian countries, Japan, China, and South Korea. Because the US strongly opposed the EAEC idea, Japan refused to join, and consequently the EAEC idea was killed in its infancy. 27 After the 1997–1998 economic crisis Japan proposed to establish an Asian Monetary Fund (AMF), a regional monetary fund as an institutional response to the inadequate actions of the IMF in helping Asian countries during the crisis. Due to US strong opposition, Japan eventually dropped the AMF idea. 28

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26 Ferlez, ‘China Creates a World Bank of its Own, and the US Balks’.
The EAEC and AMF cases further vindicate the ‘leadership transition’ argument regarding policy choices for the existing leader state when it faces an institutional challenge in global governance. Both EAEC and AMF are in the domain of global trading and financial governance, in which the United States has been identified as a leader since World War II. It is why US policies toward EAEC and AMF are different from its policies toward other Asia-only institutions. Although Malaysia or Japan might or might not identity itself as a challenger for the United States in the EAEC or AMF, in the eyes of US policy makers the EAEC and AMF proposals had seriously threatened US leadership in the global trading and financial systems. Here, the emphasis is the level and nature of threat, not the origin of threat. In particular, Malaysia’s EAEC was a regional trading bloc in Asia that excluded the United States. It would seriously threaten the US-promoted free-trading system in the region, such as the APEC. Japan’s AMF signified Asian countries’ dissatisfaction toward the IMF and the World Bank in rescuing Asian economies in the 1998 Asian financial crises. A potential success of AMF would seriously undermine the legitimacy of the US-led Bretton Woods institutions, especially the IMF and World Bank. Therefore, according to our ‘leadership transition’ model, it is rational for the US to stay away and oppose the establishment of any new institution which might potentially challenge its leadership position in a certain arena of global governance.

However, it does not mean that the United States will always oppose any new financial institution or any Asia-only institutions. In the 1960s, the United States supported and joined the ADB. Similarly, the United States also joined the European Bank for Reconstruction and Development (EBRD) soon after the Cold War.29 Neither ADB nor EBRD was perceived by US

policy makers as a threat to the US-led global financial governance. Instead, both EBRD and ADB strengthened US leadership role as well as served US strategic interests when they were established.

One notable Asia-only institution is the SCO (Shanghai Cooperation Organization) originally known as the ‘Shanghai Five’ — a confidence-building measure for China and four other bordering countries in Central Asia. Since it is beyond the US domain of global governance, there is no way for the United States to oppose SCO although it might not like the anti-West trend of the SCO. In addition, some non-East Asian financial institutions, such as the Islamic Development Bank or the Andean Fund, are very specific to either certain Islamic countries or to a certain geographic area (Latin America for the Andean Fund). The extent of these potential ‘threats’, if any, is not high enough to undermine the US-dominance in the global economic governance, such as IMF and the World Bank. This is why the United States did not pay the same level of attention that it did toward the AMF and EAEC.

To be fair, it might not necessarily be a policy failure for Washington to refuse the AIIB in the first place because exclusive institutional balancing is what a leader state normally does in a ‘leadership transition’ situation. This strategy has worked in the past in both the EAEC and AMF cases. The failed outcome of exclusive institutional balancing toward the AIIB is not because the US has chosen the wrong strategy, but because it has picked the wrong adversary this time.

It is worth clarifying that the self-identified leadership role of the US does not always lead to an exclusive institutional balancing strategy. As mentioned before, when the US first established the Bretton Woods Institutions after World War II, its strategy was not an exclusive but an

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inclusive one. In a similar vein, the US used to encourage China to join the World Trade Organization (WTO) in 2000. Through inclusive institutional balancing, the US intended to use the rules and norms of the WTO to socialize China’s behavior in the global trading system. The above cases, however, do not refute the leadership transition model because our model only applies to a potential leadership transition in global governance. In other words, our model does not claim to explain all institutional strategies at all times. When the US established the Bretton Woods Institutions and let China into the WTO, there was no leadership transition in global governance. Instead, the US was an unquestionable leader in global governance. As the secured leader of these institutions, it is rational for the US to include others in the institutions it created and dominated. However, when its leadership is challenged, the US will choose different institutional strategies to cope with these threats as explained through our leadership transition model.

**China’s ‘Challenger’ Role and Inclusive Institutional Balancing**

Unlike the US that always confidently states what it wants to be, China often denies what it is normally perceived to be in the international system. Since the 1990s, China has been perceived as a ‘threat’ to the international system. Chinese leaders have tried hard to convince the rest of the world that the rise of China will be peaceful. To ease the suspicions of the outside world, the Chinese government even changed its official slogan of ‘peaceful rise’ to ‘peaceful development’ in 2004.31 In global governance, however, China was a latecomer that was seen as too weak to pose threats to the existing system. The major discourse regarding China’s participation in the

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existing international institutions is how to socialize China with prevailing Western rules and norms.\(^{32}\)

China’s passive role in global governance started to change after the 2008 global financial crisis, in which China became the only powerhouse of economic growth in the world. At the 2009 Davos World Economic Forum, then Chinese Premier Wen Jiabao harshly criticized ‘inappropriate macroeconomic policies’ of some unnamed countries and the ‘unsustainable model of development characterized by prolonged low savings and high consumption’. Given the origin of the financial crisis in the US, everyone knows which country was in Wen’s mind.\(^{33}\) Echoed by Russia, China started to demand a ‘bigger role’ in a new economic order. In March 2009, Chinese Central Bank Governor Zhou Xiaochuan publicly called for the replacement of the US dollar as the dominant world currency and the creation of ‘an international reserve currency that is disconnected from individual nations and is able to remain stable in the long run’. It is clear that Zhou’s talk targeted the US.\(^{34}\)

Since Xi Jinping came to power in late 2012, Chinese foreign policy is moving in a new direction, as reflected in China’s policy preference of ‘striving for achievement’ in recent years. In global governance, China has gradually identified itself as a challenger to the US, the existing leader or hegemon in the international system. For example, at the 2014 Conference on Interaction and Confidence-Building Measures in Asia (CICA), Xi advocated, ‘it is for the people of Asia to

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run the affairs of Asia, solve the problems of Asia and uphold the security of Asia’. Xi’s talk is easily interpreted as a public statement asking the US to leave the region. At the 2015 Boao Forum, Xi further proposed to establish a ‘community of common destiny’ — a Chinese vision of new security and economic order in Asia. As some commentators point out, Xi’s call for a ‘community of common destiny’ represents ‘a change from recent decades when Beijing largely worked within a US and Western-dominated international system’. In other words, Xi has identified China as a challenger, if not the challenger, to the US-led world order.

China’s role as a challenger to US leadership in the international system is also confirmed by the outside world. For example, in his 2015 State of the Union speech President Barack Obama singled out China as the challenger to the US in global governance by stating that ‘China wants to write the rules for the world’s fastest-growing region…Why would we let that happen? We should write those rules. We should level the playing field’. In an even more alarming tone, two leading policy analysts in Washington assert, ‘a long-term strategic rivalry between Beijing and Washington is high’ and China is ‘the nation most capable of dominating the Asian continent and thus undermining the traditional US geopolitical objective of ensuring that this arena remains free of hegemonic control’.

Besides the US, other nations also treat China as a challenger to the existing US-led system. It is a cliché for China and Russia to call for a multipolar world and new international order in

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their official statements every year. In the eyes of Russian leaders, China is at least Russia’s partner in challenging the US in the international system. In April 2015, Indonesian President Joko Widodo also joined the club calling for a new global economic order that ‘is open to emerging countries and not dominated by any particular group of nations’.\(^{39}\) Although Widodo did not mention China or the US by name, everyone understands that Indonesia supports the former to challenge the latter in the foreseeable transformation of global governance. China’s self-identified role as a challenger to US-led global governance is further confirmed by the outside world.

According to the ‘leadership transition’ argument, China is more likely to choose inclusive institutional balancing to challenge the existing hegemon. There are two steps in China’s inclusive institutional strategy. First, as a challenger (also a latecomer), China and other rising powers will try hard to gain more voice in the existing institutions. However, their efforts might or might not be honored by the existing hegemon or leading states. One vivid example is the difficulties for emerging economies to increase their voting power in the IMF.

Second, if the challenger’s demand cannot be met in the existing institutions, this challenger state will initiate a new institution to challenge the legitimacy of the existing institution as well as the leadership role of the hegemon in a specific domain of global governance. As H2 suggests, in order to increase the legitimacy and success of this new institution, the challenger state is more likely to initiate a new institution that includes as many member states as possible, including the existing hegemon in order to establish its own leadership in this specific arena of global governance.

The AIIB is a classic case of the second-step inclusive institutional balancing. First, China designs an inclusive multilateral institution to attract support from both developing countries and developed economies. As mentioned before, the AIIB fits into a niche for the dearth of infrastructure development in developing Asia. Moreover, China did not limit the AIIB membership to Asian countries only. It instead actively invited European countries and rich Arab countries to join the bank, based on two considerations.

First, the multilateral design can help China overcome some of the inefficient financing practices it used to experience in bilateral aid and loans for some infrastructure projects in developing nations.40 More countries, especially from the West, will boost the influence and relevance of the AIIB as well as China in the new setting of global governance. China even tried hard to invite Japan to join the AIIB because Japan’s participation would facilitate the credit rating of the AIIB. It is reported that China even promised a Vice President position to Japan to lure its support.41 In other words, China’s inclusive institutional design is not just in name but also in practice.

Second, besides the inclusiveness, the key feature of the institutional balancing strategy lies in its ‘balancing’ function through which China can use the rules and norms of the institutions to maximize its interests. Balancing is a military-oriented term in international relations, which originally means to achieve an equilibrium of military capabilities between two states. In global governance it refers to a state’s policy behavior of setting rules and norms in order to maximize its interests and constrain others’ behavior in multilateral institutions. Regarding the AIIB, China

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engaged in a ‘principled negotiation’ with other members in setting the rules and norms of the institution. On the one hand, China agreed to negotiate with other members on institutional mechanisms, such as the shareholding structure and the decision-making process. On the other hand, it insisted on its own principles in designing the AIIB.

It is reported that China originally intended to take up to 50 percent of the shares given the size of its GDP compared to other members. After some developed economies joined the AIIB, China agreed to reduce its shares in the AIIB. Eventually, China obtained 26.6 percent of the voting power when the AIIB opened for business in January 2016. Although it is still the largest shareholder of the bank possessing a *de facto* veto power, China insists that it has no intention of keeping its veto power. As President Jin explained, ‘There are still many countries on the waiting list, and when the new members join, China’s voting power will be reduced. Such *de facto* veto power will be lost gradually’. 42

Through two years of negotiation with other members, the AIIB set up a crucial decision-making process by introducing a ‘fixed’ special majority, comprising two-thirds of the number of members and representing three-quarters of the voting power. This ‘fixed’ version of a special majority is a major difference between the AIIB and the World Bank because no country is allowed to change the special majority in the AIIB. It means that China cannot do what the US normally did in the World Bank and increase the special majority to keep its veto power when its voting power was reduced after new members joined. In other words, China has voluntarily constrained its influence in the AIIB. Jin explained that the reason behind China’s self-constraint behavior is

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‘gaining credibility and building up mutual trust by collective consultation and making decisions on democratic approaches’.43

For the governance structure, however, China insists on its own principle for designing a ‘lean, clean, and green’ AIIB. For example, the AIIB Secretariat plans to have 700 personnel, which is substantially less than the 2000 employees at the ADB headquarters. Unlike the World Bank and ADB, which have sometimes set up offices in different countries, the AIIB will only assign experts and staff members to projects. This practice will not only reduce unnecessary spending for overseas offices, but also avoid duplication between headquarters and regional hubs in decision making.

More importantly, differing from the World Bank and ADB, the AIIB does not have a resident Board of Directors to run everyday business. According to the normal practice in most development banks, a resident Board is necessary for efficient oversight. China argues that it will be an unnecessary and redundant cost as well as reduce the efficiency of the decision-making process.44 However, in the eyes of others this lack of oversight by the resident Board will make it easier for the bank’s president, normally from China, to control the bank. This has been a controversial issue, because one of the reasons that Japan says ‘no’ to the AIIB is based on this allegedly less-transparent governance structure. Although it tried to convince Japan to join the AIIB, China did not change its position on the resident Board issue. Since the AIIB only began operating in early 2016, whether this non-resident Board arrangement will work as expected is still in question. However, from a governance structure perspective this governance principle will benefit China’s balancing effort in dealing with other members in the AIIB.

43 See Fu, ‘AIIB Chief Rules Out China Veto Power’.
The last feature of China’s inclusive institutional balancing lies in its leadership competition with the US through providing public goods in the AIIB. Joseph Nye Jr. suggests that a major reason for the success of the ‘American century’ that emerged in the 1940s is its unique capacity to provide the global public goods that others needed.\(^{45}\) Therefore, any challenger to the US needs to do the same if it wants to replace the role of the US in the system. China to a certain extent has competed with the US in offering public goods through the AIIB and other multilateral institutions.

In August 2014 Xi made a speech to offer ‘free rides’ to other countries in economic development during his visit to Mongolia. Xi stated, ‘China is willing to offer opportunities and room to Mongolia and other neighbours for common development. You can take a ride on our express train or simply hitchhike. All are welcome’\(^{46}\). Xi’s statement is seen as a direct response to Obama’s earlier criticism on China’s ‘free rider’ role in the international system for 30 years.\(^{47}\) In contrast to US resentment about free riders, China seems ready to provide public goods to the ‘free riders’ in the future international system.

For example, in October 2013, China proposed its ‘One Belt and One Road’ initiative to build the ‘Silk Road Economic Belt’ and the ‘21st-Century Maritime Silk Road’ that encompasses many Asian, European, and African economies. China’s ‘Belt and Road’ initiative emphasizes reviving an ancient trading route stretching from Asia to Europe as well as strengthening the interconnectivity, trade, and investment among countries in the world. It is seen as a Chinese

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version of the Marshall Plan that the US used to provide funds to rebuild Western Europe after World War II. In comparison, China’s ‘Belt and Road’ initiative will be much bigger and more ambitious than the Marshall Plan.\textsuperscript{48} If the Marshall Plan was US public goods for Western Europe, the ‘Belt and Road’ initiative is the Chinese plan of public goods for the whole world.

In December 2014 China announced a US$40 billion Silk Road Fund to improve infrastructure along its ‘Belt and Road’ countries. For the AIIB, China has committed US$50 billion. In addition, China pledged US$41 billion to the US$100 billion Contingency Reserve Arrangement (CRA) among the BRICS. The CRA is designed to provide emergency credit to the BRICS members in financial duress, the same function of the IMF globally. The similar arrangement among Asian countries is called Chiang Mai Initiative (CMI) established in 2000 after the Asian financial crisis. China contributed US$77 billion to the CMI. Although China contributes a large share of the funds in both the CRA and CMI, it voluntarily limits its drawing rights. In the CMI, it contributes US$77 billion but can borrow US$40 billion. In the CRA, China gives US$41 billion but has only US$20 billion drawing rights.\textsuperscript{49} All these commitments, however, remain only on paper since no country has ever used these emergency funds. These financial contributions and commitments at least show China’s willingness to provide public goods to the rest of the world, just as the US used to do in the past.

\textit{Followers’ Roles and Balance of Interests through Institutional Balancing}

Differing from the leader state and the challenger state, other states do not need to identify their role, but become follower states by default. However, they will need to make a decision on which


one to follow, the existing leader state or hegemon versus the challenger state, in this ‘leadership transition’ situation. A follower’s role is further divided as the leader’s follower or the challenger’s follower. As mentioned in the ‘leadership transition’ model, a state will become the challenger’s follower if it perceives some ‘specific benefits’ that the challenger and the new institution can provide. Otherwise, a state will support the existing hegemon or leader to maintain the status quo of the existing system.

Both the UK and Japan are close military allies and economic partners of the US. However, they have distinctive perceptions of China as well as different strategic priorities. Although the UK occasionally raises concerns about China’s military modernization program and defense budget transparency, it does not see China as a security threat. Instead, the UK’s bilateral relationship with China used to be influenced heavily by political and human rights issues. The UK’s Foreign and Commonwealth Office (FCO) set many ambiguous and unrealistic expectations in its policy toward China. For example, one of the objectives of UK policy toward China is to help China with internal legal and political reform. Consequently, the UK had played a ‘lecturer’ or ‘savior’ role in coping with China through criticizing China’s human right records as well as involving itself in Hong Kong’s democratic movement.

In mid-2012, UK’s then Prime Minister David Cameron’s meeting with the Dalai Lama led to a diplomatic row between the UK and China. It was reported that Cameron was effectively banned from visiting China because he did not ‘apologize’ for hosting the meeting with the Dalai Lama. In late 2013, Cameron eventually visited China for a business trip after the UK

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government publicly stated that it had ‘turned a page’ on the Dalai Lama and that Cameron had no plan to meet him again in the foreseeable future.\textsuperscript{52}

Starting from Cameron’s 2013 business trip to China, the UK’s China policy was dominated by the Treasury instead of the FCO. As mentioned before, Chancellor Osborne is a strong advocate for forging close economic ties with China. Consequently, the UK started to shift its policy priorities with China from politics and human rights to investment and economic cooperation. The Dalai Lama harshly criticized Cameron, saying that he had placed ‘money over morality’ in dealing with China.\textsuperscript{53} However, due to domestic election pressures it is not surprising that Cameron was eager to boost the UK’s domestic economy with China’s investment and trade. The AIIB, therefore, became an attractive business offer that Cameron could not reject.

The UK policy makers perceived many specific economic benefits could be gained from the AIIB. According to an official statement released by the UK Treasury, Osborne called the AIIB ‘an unrivalled opportunity for the UK and Asia’, as it would ‘give our companies the best opportunity to work and invest in the world’s fastest growing markets’.\textsuperscript{54} To start with, British companies will get more business opportunities and even favorable treatment on large infrastructure deals in Asia funded by the bank. It is worth noting that the UK is not the only country that cares about economic gains from the AIIB. Germany and other European countries also want a ‘piece of the pie’ from the massive infrastructure projects funded by the bank because

\textsuperscript{52} Nicholas Watt, ‘David Cameron to Distance Britain from Dalai Lama during China Visit’, \textit{The Guardian}, 30 November, 2013.


\textsuperscript{54} HM Treasury and Rt Hon George Osborne MP, ‘UK Intends to Become a Prospective Founding Member of the Asian Infrastructure Investment Bank’, 12 March, 2015.
the European Union is a leading exporter of construction services. Another attraction for the UK is that its support for the AIIB will facilitate an agreement with China to designate London as an offshore Renminbi (RMB) trading clearance center.

In February 2014 Chancellor Osborne met with Chinese officials to discuss the possibility of setting up an RMB clearing center in London. According to Osborne, this deal would recognize ‘London’s role as the Western center of offshore RMB trading’. Since the Chinese RMB has overtaken the Singapore dollar and Hong Kong dollar to become the eighth most used world payment currency, a burgeoning RMB business will bring huge financial gains to the UK. It is not clear how the UK’s AIIB decision is associated with the negotiation of establishing an RMB clearing center in London. In April 2016 (about one year after London joined the AIIB), London passed Singapore to become the largest offshore RMB hub outside Hong Kong, accounting for 6.3 percent of all offshore transactions using the Chinese RMB.

The UK’s decision to join the AIIB is an inclusive institutional balancing effort toward China’s ambition. On the one hand, London’s participation is well appreciated and rewarded by Beijing. In addition to the RMB clearing center, the UK secured a vice president position in the AIIB. On the other hand, the UK claimed that it would use its own influence and power to constrain China’s behavior in the bank so that the AIIB can maintain the ‘best practices’ in financing infrastructure development. As UK officials point out, one of the reasons for the UK to join the

AIIB is to ensure that ‘Britain will be able to shape the new institutions’.58 In other words, the UK will not always say ‘yes’ to China in the AIIB. Instead, it will use its influence and voice to ensure that the AIIB will sustain international standards in financing infrastructure projects as well as prevent the AIIB from becoming China’s diplomatic tool to expand its own interests.

Other Western powers will be expected to do the same because the multilateral setting provides a mechanism for them to constrain or even undermine China’s influence in the AIIB. It is still too early to assess whether and how the counter-balancing role of the UK and other European powers will work in the AIIB. It is clear that the UK, as an insider of the AIIB, will play a much larger role than outside powers, such as the US and Japan, in monitoring and shaping the future development of the AIIB.

Although China was the largest trading partner of Japan, the bilateral relations between the two nations have been overshadowed by territorial disputes, historical memories, and security competition since the late 2000s. The 2009 boat collision crisis between the two nations intensified the territorial disputes over the Senkaku/Diaoyu islands. Japan’s official ‘purchase’ of the islands in 2012 further deteriorated its relationship with China. Nationalism and historical memories have also added fuel to the fire for the troubled relations between the two nations. Since 2010, China has overtaken Japan to become the second-largest economy in the world after the US. The economic and military power transformation between China and Japan has also deepened Japan’s security concerns over China. For example, in the 2014 Japanese Defense White Paper Japan singled out China and North Korea as two security threats for Japan’s national security. In particular, Japan expressed strong concerns over China’s military build-up and assertive activities

in both the East and South China Seas, including China’s announcement of the Air Defense Identification Zone (ADIZ) over the Senkaku/Diaoyu islands in late 2013.\textsuperscript{59}

Regarding China’s AIIB proposal, Japanese policy makers perceived more costs than benefits. Basically, Japanese leaders needed to consider two types of cost regarding the establishment of the AIIB. The first cost is Japan’s regional leadership in financial governance in the Asia Pacific. According to a report from the \textit{Economist}, Abe says that, ‘he continues to view the AIIB with deep suspicion, as a means to expand China’s strategic and economic power’.\textsuperscript{60} It is understandable because China’s AIIB also poses a direct challenge or threat to Japan’s regional status, especially in the regional financial governance in the Asia Pacific. As mentioned before, Japan has held a leadership position in the ADB in the US-led Bretton Woods system of the post-war era. China’s AIIB not only threatens US leadership in general, but also targets Japan’s role in the ADB in particular. The major reason for the rise of the AIIB is rooted in the unsatisfactory performance of the ADB in financing infrastructure development in Asia. Clearly, the success of the AIIB will weaken the relevance of the ADB as well as Japan’s sub-regional leadership in Asia. Therefore, if we operationalize the ‘leadership transition’ model in a regional domain, Japan is playing a ‘leader state’ role in regional financial governance while China is a challenger. Therefore, just like the US who cannot accept China’s challenge in the global domain, Japan will not accept the AIIB from a regional leadership perspective. The reason is also simple — just because the AIIB led by China will threaten Japan’s leadership in regional financial governance in the Asia Pacific.


\textsuperscript{60} \textit{Economist}, ‘To Join or not to Join’, 28 May, 2015.
Another cost-related factor that discouraged Japan from joining the AIIB is its alliance relationship with the United States. Since the United States had said ‘no’ to the membership of AIIB, ‘Japan would be breaking ranks with its ally should it join’. In addition, ‘it would look especially odd soon after a trip by Mr. Abe to Washington in April [2015] that was aimed at strengthening Japan’s alliance with America’. It is clear that the Japan-US alliance became another constraining factor preventing Japan from embracing the AIIB. In other words, the perceived benefits from the AIIB, if any, will not be able to outweigh the potential costs, including China’s strategic pressures, the loss of Japanese status, and potential damages to the alliance relation with the US.

Consequently, Japan adopted an exclusive institutional balancing strategy against the AIIB. Just as the US did, it firmly refused to join the AIIB no matter how hard China tried to negotiate terms for Japan’s possible membership. It is reported that President Xi even scheduled a special meeting with Prime Minister Shinzo Abe in April 2015 to persuade Japan to join the AIIB. However, Japan decided to stick with the US and stay away from the AIIB.

Japan also conducted an inter-institutional balancing strategy, an extension of exclusive institutional balancing, to undermine the potential influence of the AIIB. In May 2015 (about one month after the establishment of the AIIB), the ADB led by Japan announced that it would raise its funds for infrastructure and other projects by nearly 40 percent to US$18 billion. As some commentators suggest, the ADB’s decision is not a coincidence. It will serve Japan’s interest if

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61 *Economist*, ‘To Join or not to Join’.
the ADB can ‘steal the thunder’ from the AIIB. Moreover, in the same month, Japan announced that it planned to provide US$110 billion in aid for Asian infrastructure projects over five years.\textsuperscript{65} It is worth noting that the amount of Japanese funds tops the expected total US$100 billion funds of the AIIB. There is no doubt that Japan has tried to use its own institutions, such as the ADB and this huge aid program, to counteract China’s challenge to its regional leadership in the finance domain in the Asia Pacific.

Conclusion

Integrating role theory and institutional balancing theory, we introduce a ‘leadership transition’ argument to explain the diverse policy responses of states towards the AIIB. Global governance has diverse issue-areas and our ‘leadership transition’ model suggests that states identify their different roles during a potential leadership transition in a specific arena of global governance. When a challenger state proposes a new institution, it will signal a potential leadership transition in this special domain of global governance. To pool support and strengthen legitimacy of the new institution, the challenger state is more likely to conduct an inclusive institutional balancing strategy to provide extra benefits as public goods, which the old system cannot provide, through the new institution. China’s inclusive design of the AIIB as well as its generous funds as public goods for infrastructure development vindicate this argument.

The existing leader state in the system, however, is more likely to reject the new institution initiated by the challenger state through an exclusive institutional balancing strategy, as we have shown through the strong US opposition to the AIIB and its failed containment efforts in Europe.

and Asia. For other states the ‘leadership transition’ model suggests that they have to pick sides between the challenger state and the leader state in the system. If they perceive some specific and concrete benefits from the challenger, they will choose to support the new institution initiated by the challenger state because of the attraction of the ‘goodies’, as we can see in the case of the UK changing its mind to support the AIIB. However, if a state does not perceive enough benefits or potential costs will outweigh perceived benefits, it is more likely to bandwagon with the existing leader that can provide more stability through the existing system. Japan’s rejection of the AIIB is caused by this insecure perception regarding the rise of China in both economic and security domains.

Although it is unclear whether the AIIB will trigger a leadership transition from the US to China, there is no denying that the AIIB will not be the last opportunity for China to challenge US leadership in the financial dimension of global governance. Our ‘leadership transition’ model of global governance engages the existing literature on China and global governance and highlights institutional dynamics among states in a potential leadership transition period of global financial governance. While most research on China and global governance focuses on how China accommodates, challenges, and shapes rules and norms in global governance, our model emphasizes the interactions among ‘the leader’, ‘the challenger’, and ‘the follower’ through institutional strategies in a potential leadership transition in global governance.66 Differing from

what traditional ‘power transition’ theory predicts about a possible conflict between China and the US, we suggest that the ‘leadership transition’ between the US and China in global governance can be peaceful through institutional competition.67 The existing hegemon and beneficiaries of the existing system will need to consider how to accommodate China’s legitimate requests to achieve a peaceful transformation of the international system.

Lastly, institutional balancing is by no means the only game in town. The hegemon can still use military-based balancing strategies to take down the rising power. A rising power can also use force to pursue their ‘place in the sun’. For example, after World War I, the UK and France intended to use League of Nations (inclusive institutional balancing) to constrain Germany and Japan. However, this inclusive institutional balancing did not work. Both Germany and Japan withdrew from the League of Nations. Rather than pursuing other institutional means, they waged war and used military means to challenge the existing international order. After the 2008 financial crisis, we also witnessed military-based balancing efforts of the US toward China in the Asia Pacific through its ‘pivot’ or ‘rebalance’ strategy. We argue that a relatively peaceful leadership transition through institutions is still possible if policy makers in China and the US are wise enough to overcome the temptations and fears rooted in traditional military balancing and the employment of hard power.
